

Fiscal anxiety strikes again

By Taylor Schleich, Ethan Currie & Warren Lovely

As Washington keeps Greenland in its rhetorical crosshairs, investors are left to contend with unsettling geopolitical risks. On Tuesday, there wasn't a military invasion but there was a financial one: bond vigilantes have stormed Japan. Fiscal policy concerns drove the long end of the Japanese government yield curve sharply higher, with yields jumping nearly 27 basis points in a single session—the largest one-day move on record. And this followed an 11 basis point sell-off on Monday. There's been some collateral damage as longer-term yields are moving up across global bond markets, despite the broader risk-off tone.

Of course, this is not the first time we've seen investors fret over Japan. Long-end yields have more than doubled over the last two years despite only very modest monetary policy tightening. The cumulative damage, believe it or not, has left a 30-year JGB yielding slightly *more* than a 30-year GoC bond. The last time we saw that? That would be never. (Note: Japan only began issuing 30-year debt in 1999).

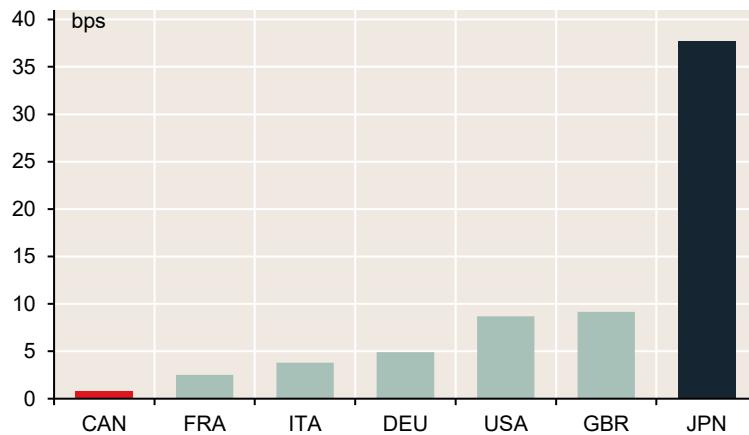
It's easy enough to understand why investors would worry about Japan's fiscal situation. The Prime Minister's pledge to lower taxes if re-elected

would involve greater debt for a country that already bears the largest gross and net debt burden in the G7. Notwithstanding a more captive domestic investor base in Japan, this kind of unsustainable fiscal policy is evoking memories of the UK's budgetary mayhem in the fall of 2022.

This episode offers another reminder that sovereign fiscal trajectories are increasingly important to investors. Those too loose will be punished, while more 'responsible' governments (e.g., Canada) are rewarded, at least on a relative basis. In Canada, relative fiscal strength has for years been flouted by governments and emphasized by strategists, including ourselves. Of course, there's some nuance to these comparisons. For example, Canada's debt advantage is far more about *net* debt than *gross* debt. Moreover, Canada's relative fiscal strength may marginally erode over coming years as deficits are expected as far as the eye can see. Still, this advantage exists and its dividends are evident in times like these. Among G7 nations, Canada's long-end has sold off the least over the past week. And structurally, GoC bond investors require less marginal compensation to move from the 10-year sector of the curve out to longs.

Chart 1: Japan has led global yields up (some more than others)

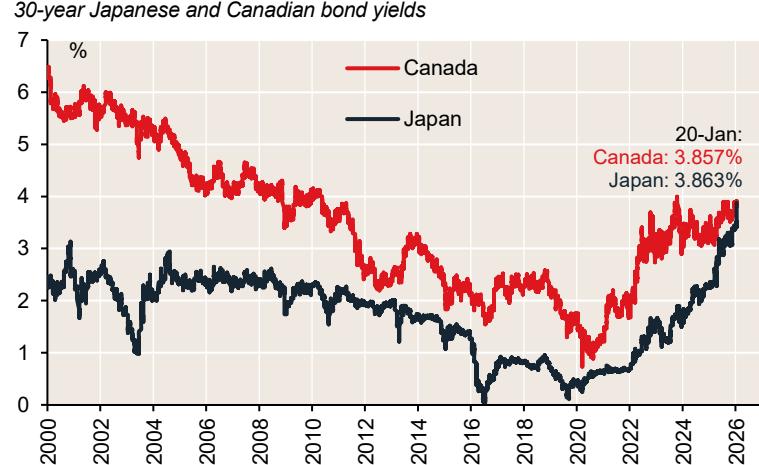
1-week change in G7 30-year bond yields



Source: NBC, BBG

Chart 2: 30-year JGB yield > GoC yield for first time ever

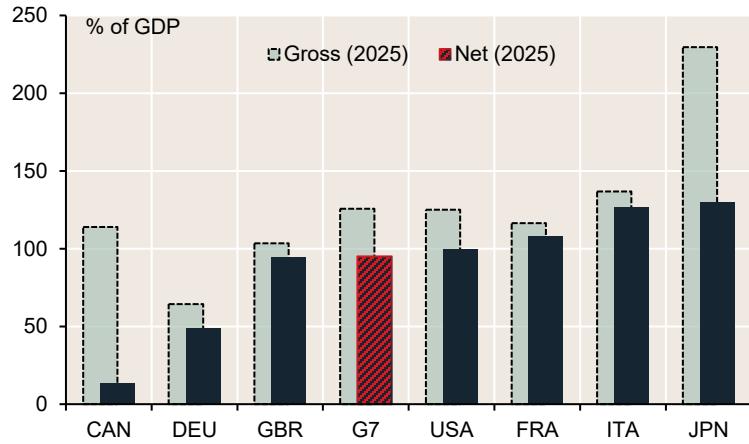
30-year Japanese and Canadian bond yields



Source: NBC, BBG | Note: Yield level at 12:25 PM EST.

Chart 3: Japan carries a heavy debt load...

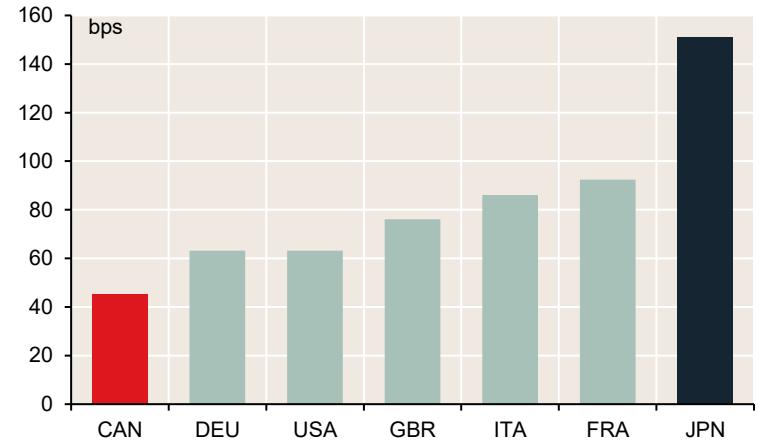
General government gross & net debt-to-GDP ratios: 2025



Source: NBC, IMF | Note: CAN includes federal outlook from Dec-24 FES

Chart 4: ...contributing to a relatively steeper yield curve

Current 10s-30s yield curve of G7 nations



Source: NBC, BBG



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